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Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1687

UNITED STATES TRUST COMPANY OF NEW YORK, as Trustee for The Port Authority of New York and New Jersey Consolidated Bonds, Fortieth and Forty-First Series, on its own behalf and on behalf of all holders of Consolidated Bonds of The Port Authority of New York and New Jersey and all others similarly situated,

Appellant,

v.

THE STATE OF NEW JERSEY, BRENDAN T. BYRNE, Governor of the State of New Jersey, and WILLIAM F. HYLAND, Attorney General of the State of New Jersey,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF NEW JERSEY

APPELLANT'S REPLY TO MOTION TO DISMISS APPEAL

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The legislation which the State of New Jersey unanimously enacted and vigorously defended in the *Courtesy Sandwich Shop** case only 13 years ago has now become, to appellees, "absurd" (B** 21), allegedly of no value to bondholders but rather a peripheral redundancy for a "specially privileged class" (B 2)—those private investors who loaned over one billion dollars of private capital to a state agency in reliance upon the word of the state. The

* *Courtesy Sandwich Shop, Inc.* v. *The Port of New York Authority,* 12 N.Y.2d 379, *appeal dismissed,* 375 U.S. 78, *rehearing denied,* 375 U.S. 960 (1963).

** "B" refers to Appellees' Motion to Dismiss. "T" refers to the trial transcript. "Stip." refers to the stipulation.

contract with bondholders which the states determined was absolutely necessary to the assumption of the Hudson & Manhattan by the Port Authority is now, to appellees, an impediment which had a "profoundly deleterious effect" on transportation (B 4).

Appellees' motion is based primarily upon their reiteration of the trial court's conclusions of fact, which are not binding upon this Court. *E.g., Fiske* v. *Kansas,* 274 U.S. 380, 385 (1927); *Kern-Limerick, Inc.* v. *Scurlock,* 347 U.S. 110, 121 (1954).

A. The trial court's findings with respect to the effect of repeal.

Two wholly distinct and independent grounds of impairment were demonstrated below, each of Constitutional proportions: (1) repeal of the Covenant cancelled a security device valuable to bondholders and (2) repeal adversely affected the secondary market for the bondholders' investments. The trial court acknowledged the first ground of impairment:

> "To the extent that the repeal of the covenant authorizes the Authority to assume greater deficits for [deficit rail mass transit] purposes, it permits a diminution of the pledged revenues and reserves and may be said to constitute an impairment of the states' contract with bondholders." (A 95) (footnote omitted)

and also the second:

> "There can be no question but that immediately following repeal and for a number of months thereafter the market price for Port Authority bonds was adversely affected. This was conclusively demonstrated by plaintiff's exhibits comparing the market price of selected Port Authority bonds, before and after repeal, with the prices of comparable bonds over the same period." (A 92)

The trial court found also that if the Covenant is to be understood in the sense that it furnished "security for the bondholders and . . . protected the diversion of the earnings of the Port Authority into deficit mass rail transit" then "the record supports plaintiff's claim that investors relied on the Covenant in purchasing Authority bonds." (A 91).

It is not, as appellees suggest, that the trial court found "no adverse effect upon bondholders" as a result of repeal. (B 5). Rather, the trial court described an *eight month* market decline as "short-term" and said in effect that bondholders should be satisfied with the various tests and other bondholder protections which preceded enactment of the 1962 Covenant and which remain in effect. These very same tests and protections were considered in 1962 to be wholly inadequate to ensure the continued acceptance of Port Authority obligations in the face of the agency's first entrance into the field of perpetual deficit rail mass transit.* Absent the Covenant, the states' power to direct the Port Authority into deficit rail mass transit was only theoretical since the necessary financing would never have been forthcoming on acceptable terms. (A 90).

Appellees say on the one hand (B 7, 21, 22) that the 1962 Covenant is superfluous for bondholder protection and on the other (B 13) that only by repeal of the Covenant can hundreds of millions of dollars of pledged revenues and reserves be diverted to rail mass transit. Then they seek

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* Appellant showed below, as a hypothetical demonstration of the inadequacy of other bondholder "protections", that the other tests would not prevent a takeover by the Port Authority of a New York City subway line. While such a takeover may be unlikely (even though Mayor Beame has proposed diverting Port Authority revenues to the subways), the Port Authority financial expert who was called at the request of the trial court testified that of all of the tests and other bondholder protections *only* the 1962 Covenant would prevent a Port Authority takeover of the Second Avenue subway line in New York City (T 546-549). Bondholders are now to be satisfied with only these other so-called protections.

to justify the diversion by reference to an alleged windfall to the agency as a result of repeal:

> "The toll increase revenues, estimated at $40 million per year, will be used to finance mass transit projects that remained dormant while the Covenant stood. See A80-84.
>
> . . .
>
> "Appellant's assertion that bondholders have lost $240 million of 'their' protection J.S. 24 fn., 18, is plainly contrary to fact. All of that money, and much more, will come from funds generated by the toll increase, not otherwise available to bondholders." (B 12-13).

The toll increases upon which Appellees rely to sustain retroactive repeal of the Covenant in 1974 were instituted almost one year *after* repeal. Rather than being a carefully formulated exercise of the police power, the announcement of the toll increases in April, 1975 prompted these reactions:

1. The Governor of New York said that he was undecided whether to approve the increases.

2. The New Jersey Assembly and New Jersey Senate unanimously passed resolutions opposing the increases and calling for a gubernatorial veto. (New Jersey State Senate Concurrent Resolution No. 3016 (April 17, 1975); New Jersey State Assembly Resolutions 3009, 3010 (April 24, 1975)).

3. The New York State Senate passed a resolution urging Governor Carey to veto the increases. (New York State Senate, Resolution No. 51 (April 15, 1975)).

4. The Governor of New Jersey said that he had not been consulted regarding the increases and then announced that he would veto the increases unless

the Port Authority immediately reinstituted a commuter discount (thus encouraging additional automobile traffic), which the agency agreed to do.

5. A member of Congress and other groups and individuals instituted a proceeding to challenge the increases as violative of the Federal Bridge Act of 1906 (34 Stat. 84).*

Appellees' repeated references to the estimated $40 million in new annual revenues from the toll increases are inexplicable in light of the fact that the Port Authority's own Annual Report** for 1975 flatly refutes any contention that the toll increases have enhanced materially the agency's net revenue or reserve position. The toll increases were instituted on May 5, 1975. At an alleged annual rate of $40 million in new net revenue approximately $26.7 million in new net revenue should have been realized by the Port Authority during 1975. While *gross* revenues increased by $48 million (versus a $37 million increase in the prior year), *total* Port Authority revenues before debt service in 1975 increased by only $14.03 million (disregarding securities value adjustments), and surplus reserves in excess of mandated bonded debt service, which might be considered the true "surplus" of the Port Authority, rose from $23,570,000 to $23,866,000, an increase of only $296,000, not the $26.7 million which supposedly was realized from the toll increases. Operating expenses alone increased by over $37 million from 1974 to 1975, more than consuming any new revenues resulting from the toll increases.

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* This case, which if successful could result in a rollback of the toll increases, has not yet been decided. In April, 1976 the Federal Highway Administrator ordered that public hearings be held to review the toll increases.

** A public document subject to judicial notice. *E.g., Bush Terminal Co.* v. *City of New York*, 282 N.Y. 306, 316 (1940); see *United States* v. *Louisiana*, 363 U.S. 1, 12-13 (1960); *Deutch* v. *United States*, 367 U.S. 456, 470 (1961); *cf.* Fed. R. Evid. 201(b).

Appellees refer (B 8-9) to the post-trial effort by one of Appellant's experts to support and improve the market for Port Authority Bonds. As stated in an affidavit by the expert submitted to the New Jersey Supreme Court, this effort "had very limited and short-lived success because institutional investors continued to be unwilling to purchase Port Authority Consolidated Bonds given the possibility of substantial involvement of the Port Authority in deficit rail mass transit operations."

Appellees refer to the rating agency reports on the Port Authority (B 9), but the rating agencies have not yet evaluated any Port Authority bond issue for additional mass transit purposes, and Appellant showed at trial that Port Authority bonds declined in the market as compared with bonds of the same rating. (*E.g.*, T 127-10 to 128-25). Appellees say that the Port Authority rather than bondholders sought the 1962 Covenant (B 9), a statement expressly contradicted by the trial court, which found that the Covenant was enacted "so as to promote continued investor confidence in the Authority." (A 90).

B. The trial court's finding that the retroactive repeal of the 1962 Covenant was a proper exercise of the police power.

Appellees would equate happenstance with legislative history—they discuss at length (B 10-12) energy and environmental factors* as though quoting from some detailed legislative history of the retroactive repeal of the Covenant. No such history exists. In striking contrast to the enactment of the Covenant and its prospective repeal, the retroactive repeal was enacted without legislative fact-finding, without meaningful legislative debate, without

* There were much the same concerns at the time the Covenant was enacted. (Stip. 52-58).

public hearing to allow opponents or bondholders to express their position. (Stip. 348).*

There is no exercise of the police power here. The repeal of the Covenant has one purpose and one effect—it enables the states to transfer from taxpayers to a public authority the obligation to pay for an unquantified and unquantifiable additional part of the rail mass transit deficits of Metropolitan New York. The case involves money, and only money.** Anything which might be accomplished with repeal can to the same extent be accomplished without repeal if the states, or either of them, are willing to stand behind the necessary financing.

C. The federal questions are substantial.

A selective history of judicial interpretations of the contract clause (B 13-19) leads appellees to the conclusion that the states may "modify contracts where the end is legitimate and the measures taken are reasonable." (B 19). Here, of course, there is no "modification" but rather the total cancellation of the contract in question. The "municipal bond" cases cited by appellees (B 20-21) lend no support to their contention that a state may unilaterally abrogate a security device in a bond contract.

* Not one legislator from either state, nor either Governor, publicly expressed even the most casual connection between retroactive repeal of the 1962 Covenant and any energy or environmental problem.

** That the case involves only money may be illustrated by the fact that prior to repeal of the Covenant the State of New Jersey had committed itself to fund the local share of the PATH extension to Plainfield, New Jersey, then estimated at $40 million. Upon the change in administrations and subsequent retroactive repeal the state reneged on this commitment and instead said that the Port Authority should fund the local share of the extension. The concern of bondholders with a revenue agency's involvement in deficit rail mass transit may be illustrated by the fact that in only three years this local share of the PATH extension alone has risen from $40 million to $80 million to $128 million.

Of the four Massachusetts opinions cited, the two Opinions of the Justices are advisory opinions which have no binding precedential value. *City of New Bedford* v. *New Bedford, Woods Hole, Martha's Vineyard and Nantucket S.S. Authority,* 336 Mass. 651, 656, *appeal dismissed,* 358 U.S. 53 (1958). In *Opinion of the Justices,* 313 N.E.2d 882 (Mass. 1974), the court upheld a statute cancelling a property tax exemption for lessees from the Authority while saying that the tax exemption would have been enforced if it were clear that the legislature had originally intended to conclude a binding contract to that effect. In *Massachusetts Port Authority* v. *Treasurer and Receiver General,* 352 Mass. 755 (1967), the Authority was responsible only for partial payment of its predecessor's employee benefits; the impairment, if any, was plainly insubstantial. In *New Jersey Sports & Exposition Authority* v. *McCrane,* 61 N. J. 1, *appeal dismissed,* 409 U.S. 943 (1972), the only discussion of the contract clause was *dictum;* the case did not involve an impairment. Nor did *Arizona State Highway Commission* v. *Nelson,* 105 Ariz. 76 (1969). *Beaumont* v. *Faubus,* 239 Ark. 801 (1965) sustained the deposit of United States government bonds in an irrevocable trust in substitution for prior security; the bondholders' security was in fact enhanced. In *City of New Bedford, supra,* there was no threat to the security of the bonds because, unlike the Port Authority, the Commonwealth stood behind the agency and would loan it money (to be recovered by a special tax) to cover any reserve fund deficit. *Opinion of the Justices,* 334 Mass. 721 (1956) did not involve an impairment; it was strictly an advisory opinion. In *Jacksonville Port Authority* v. *State,* 161 So.2d 825 (Fla. 1964), the challenged transaction added another obligor to an issue of general obligation bonds, thus putting the bondholders in a *better* position than before. Until the present case, courts which have in fact considered impairment of covenants in municipal bond contracts have been unanimous in their condemnation of state attempts to subvert any material part of the bond contract. *E.g., First National Bank* v. *Maine Turnpike Authority,* 153 Me. 131 (1957); *Ruano* v. *Spellman,* 81 Wash. 2d 820 (1973); *see Opinion of the Justices,* 356 Mass. 775, 794-96 (1969).

Appellees say again (B 21) that bondholders are not damaged by repeal. If this is so, if material amounts of pledged revenues and reserves are not to be diverted to deficit rail mass transit, then why repeal the Covenant?

Appellees rely on a successful bond issue by the Port Authority in 1962 on the eve of the Covenant's enactment and on the agency's financing success while the Covenant was in effect* (B 23) as evidence that the Covenant was *not* relied upon! This since investors supposedly were on notice that the Covenant was cancellable at the whim of the states. To say that this is contradicted by the record is an understatement. (*E.g.,* T 93-5 to 6; T 239-4 to 240-7; T 58-16 to 18; T 275-2 to 10; T 82-4 to 15; T 84/85-22 to 86-17; T 317-20 to 318-8; Stip. 184, 255; T 398-12 to 17). Nor did the *prospective* repeal of the Covenant in 1973 (B 23-24) affect investors' reliance on it, since it was widely known that the Covenant would continue to protect all outstanding Port Authority obligations until the maturity in 2007, or the unlikely earlier retirement, of all outstanding bonds directly affected by the Covenant. This is why Appellant (T 850-13 to 853-17) and other institutional investors (T 764-21 to 765-7) continued to purchase Port Authority bonds after the prospective repeal; these *same* investors immediately ceased buying and in fact began to liquidate their holdings when retroactive repeal appeared to be possible. (T 764-15 to 765-16).

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* In any case, the sale of bonds at 3½%, or 6%, or 5½% is, in itself, meaningless absent a sophisticated analysis of the interest rates borne by contemporaneous issues of bonds of similar maturity and varying quality. For example, a sell-out at 6% is not in fact successful if comparable issues are yielding only 5%.

Appellees say:

> "[A]ppellant neglects to advise the Court of the fact that at the time of trial (February 1975) the prices for bonds of the Port Authority of New York and New Jersey and of the Massachusetts Port Authority (an agency selected for comparison by appellant) bore exactly the same relationship to each other that they did when appellant's exhibits began (July 1973) and immediately prior to the repeal of the covenant (April 1974). A92-93." (B 25).

And appellees neglect to advise the Court that (1) the rise in the market for Port Authority bonds was caused by technical market adjustments (T 182-11 to 12; T 409-7 to 411-14), and not by any reevaluation of the agency's credit; (2) the technical rise in the market did not occur with respect to the other Port Authority issues analyzed by Appellant's experts; and (3) the technical rise in the market was short-lived; Port Authority bonds soon fell to their former depressed level where, with minor variations, they have remained.

The obvious flaw in appellees' defense of repeal is that the 1962 Covenant did not for a moment restrict either state in taking direct and effective action in response to the evils now asserted to justify its unilateral cancellation. The police power defense is an illusion; the federal questions presented by this appeal are plainly substantial.

D. This Court may note probable jurisdiction and defer further consideration pending determination of the related case.

Appellees' statement that the resolution of the related case "turns entirely on the federal issues" which were "fully litigated" in this case is erroneous and inconsistent with their request (A 105), that the New Jersey court decide the issue of the validity of the New York repeal under

the New York Constitution (Article I, §§6, 7). After declining to do so, the New Jersey court based its decision solely on the contract clauses of the United States and New Jersey Constitutions and did not consider the due process validity of the repealer. (A 94 fn. 36).

Appellee's suggestion that the decision in the New Jersey case will estop Appellant from litigating the validity of the New York repealer in New York courts is frivolous. In declining to consider the entirely separate issue of the validity of the New York repealer, the New Jersey trial court said ". . . that question should be left to the New York courts for decision. . . . It may be noted that U.S. Trust has filed a declaratory judgment action in the New York Supreme Court which is presently pending." (A 105 fn. 42). Contract rights are property rights entitled to protection under the due process clause of the New York Constitution. *E.g., Tilton* v. *City of Utica,* 60 N.Y.S.2d 249, 263-65 (Sup. Ct. 1946). New York Courts are considerably more reluctant than those in New Jersey to approve state action which impinges on contract rights even where, unlike the present case, a *bona fide* emergency prompts the impairing legislation and the state has agreed to stand behind the contract right in issue. *Sgaglione* v. *Levitt,* 37 N.Y.2d 507 (1975).

CONCLUSION

This Court should reverse the judgment of the Supreme Court of New Jersey or, in the alternative, note probable jurisdiction of the appeal and, if the Court deems it appropriate, order the appeal deferred pending resolution of the related action in New York.

Respectfully submitted,

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